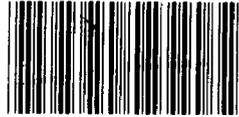


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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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COMPREHENSIVE STATEMENT OF
WILLIAM J. ANDERSON, DIRECTOR,
GENERAL GOVERNMENT DIVISION



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BEFORE THE
SUBCOMMITTEE ON COMMERCE, CONSUMER AND MONETARY AFFAIRS
HOUSE COMMITTEE ON GOVERNMENT OPERATIONS
ON THE
INTERNAL REVENUE SERVICE'S EFFORTS
AGAINST ILLEGAL TAX PROTESTERS

Mr. Chairman and Members of the Subcommittee:

We are pleased to assist the Subcommittee in its inquiry into the illegal tax protester problem. Our testimony is based on the results of our review of the Internal Revenue Service's (IRS') efforts to detect and deter illegal tax protesters. The review was done, of course, at the Subcommittee's request. (A brief description of the objectives, scope, and methodology of our review is included as appendix I.)

We would like to state at the outset that the illegal tax protest movement has grown significantly in the past few years. Although it is but a part of the "subterranean economy," it alone poses a threat to our Nation's voluntary compliance tax system. To counter this threat, IRS has taken some important

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actions in recent years. In 1978 it established a nationwide program to systematically identify and pursue illegal tax protesters. In 1980 it initiated a program to identify individuals, including protesters, who file incorrect withholding certificates to evade taxes. Very recently IRS has taken some actions to enhance the timeliness and effectiveness of its efforts. As a result of these efforts, IRS has had some important successes in detecting protesters and deterring them through its civil and criminal enforcement actions.

Despite these actions and successes, IRS needs to improve its ability to identify illegal tax protesters. It also needs to improve its efforts to bring protesters into compliance by investigating them in a more timely and effective manner. In addition, IRS needs to develop an overall strategy and provide for collateral information to better target its resources and maximize their deterrent effect on the protester problem.

We would now like to discuss (1) the nature and extent of the illegal tax protest movement, (2) the various schemes used by protesters, and (3) the adequacy of IRS' efforts to detect and deter protesters, including improvements IRS can make in its illegal tax protester program. But first, let us distinguish between legal and illegal tax protesters.

LEGAL AND ILLEGAL TAX PROTESTERS

Taxpayers need and have legal ways to protest the Government's tax policies. Legal tax protesters generally seek to change the tax laws through legislation, while continuing to pay

taxes in accordance with existing laws. They are legally and peacefully exercising their right to petition the Government. Tax law lobbyists are probably the most common form of legal protesters. The State of California's "Proposition 13" movement is an example of a legal tax protest.

In contrast, IRS defines an illegal tax protester as "a person who advocates and/or participates in a scheme with a broad exposure that results in the illegal underpayment of taxes." These protesters attempt to undermine the tax system by using various schemes that lead to the evasion of taxes. Some attempt to interfere with the efficient administration of the tax system by harassing IRS employees in various ways. Some even advocate the use of violence, thus subjecting those IRS employees who deal directly with them to the threat of physical harm.

NATURE AND EXTENT OF ILLEGAL TAX PROTEST MOVEMENT

The illegal tax protest movement began in the early 1920s. Until a few years ago, the movement was centered mainly in the Western and Southwestern parts of the country, and was viewed by IRS as a local compliance problem. The movement consisted of a few individuals who shared similar views regarding the constitutionality of taxes and who practiced and promoted illegal schemes. The schemes were simple and straightforward--individuals would not file tax returns, or would file returns but report no income.

The movement grew in the late 1960s, when protest returns were filed by individuals who belonged to geographically isolated groups who shared similar beliefs regarding (1) the Government's

right to tax individual income, (2) the taxability of paper money versus gold or silver, and/or (3) the unwarranted growth of Government. They generally used a particular protest scheme which involved filing a blank form 1040 tax return and citing the 5th amendment or monetary arguments. These arguments have long been denied by the courts.

In recent years, the movement continued to grow and spread across the country as protesters made speeches and offered seminars, often misrepresenting the tax laws. According to an IRS regional illegal tax protester task force report, the movement became more appealing to some persons as our Nation's economic conditions worsened. Today people from all walks of life are involved, and the schemes are more sophisticated.

Although it is apparent that the illegal tax protest movement is growing, the exact extent and makeup of the movement are unknown. The best available data on the number of illegal tax protesters are probably those compiled by IRS. This data is based on tax returns primarily identified by IRS' 10 service centers as being filed by illegal protesters.

As shown in appendix II, IRS identified about 7,100 protest returns in calendar year 1978, when it first began collecting data, and about 18,200 protest returns in calendar year 1980--an increase of about 156 percent. Part of this growth is attributable to possible improvements in IRS identification procedures. Notwithstanding this possibility and the fact that the number of IRS-identified protest returns is still relatively small, the growth rate is alarming.

According to IRS, the number of protesters connected with the returns it identified increased from about 7,700 in 1978 to 20,800 in 1980. The difference between the number of protesters and the number of returns is attributable mainly to the fact that IRS counts a joint return as one return involving two protesters.

Although this is the best available data, the figures overall are understated because of problems in IRS' identification procedures, which we will discuss later. For example, IRS figures generally do not include protesters who chose not to file a return or otherwise notify IRS of their protest. Further evidence that these figures may be understated is the fact that, during its first 6 months of operation, IRS' program to detect false form W-4s yielded 143,000 questionable W-4s for followup. Although neither we nor IRS know how many of these will be identified as having been filed by protesters, some will involve protesters. Nevertheless IRS' data on identified protest returns, in our opinion, is sufficient to show that the problem is growing.

As shown in appendix III, the breakdown of IRS' data by service center reveals that illegal protester activity continues to be heaviest in the West and Southwest. However, it is intensifying across the country and has had the largest percentage increase in the Northeast.

Presently, IRS does not generate periodic statistics on the characteristics of illegal tax protesters or on the amount of taxes involved in these protests. Although certain data on characteristics can be found within the management information systems of individual IRS divisions, no profile reports are

prepared for the overall protester program. We can provide some profile information, however, which is based on a sample of protester cases. We selected these cases from among those which IRS put in its protester program in 1978 and 1979 in three of its districts--Des Moines, Los Angeles, and Manhattan. 1/

We estimate that 58 percent of the illegal protesters in the three districts were nonprofessional wage earners, 19 percent were professional persons and either self-employed or wage earners, 9 percent were nonprofessional self-employed persons, 8 percent had an unknown occupational status, and 6 percent involved other minor classifications. Some interesting subgroups within these broad occupational categories include doctors (9 percent), teachers (7 percent), and government employees (6 percent).

About 46 percent of the protesters had incomes between \$15,000 and \$50,000, and another 17 percent had incomes between \$10,000 and \$15,000. The highest income noted was about \$275,000. We estimate that about 7 percent of the protesters were either local or national leaders; and about 78 percent limited their protest activity to just filing a protest return. Another 8 percent were nonfilers who told IRS they were protesters, and the remainder involved other minor categories.

1/Throughout our testimony, unless otherwise specified, our sample results from 167 randomly selected illegal tax protester cases are projected to the estimated universe of 3,870 tax protester cases in the three districts. This estimated universe was used because our original sample of 222 cases included 16 cases on which IRS could not provide records and 39 cases which IRS erroneously placed in its protester program. We excluded the erroneous cases from our projections and reduced the universe accordingly. We are 95 percent confident that the estimated universe is accurate within \pm 181 cases. See appendix I for a more complete explanation of our methodology.

On the basis of IRS' proposed tax adjustments, we estimate that the average amount of additional taxes involved when an adjustment was proposed was \$3,690. ^{1/} The highest proposed tax assessment was \$49,989. We estimate that total taxes involved in the 1978 and 1979 protester cases in the three districts amounted to \$10.2 million. In an estimated 1,106 cases, IRS ultimately will not propose a tax adjustment. This includes cases such as those not pursued by IRS. Neither we nor IRS know the annual impact of illegal tax protesters on total tax revenues. However, our review indicates that, although the number of protesters is relatively small, substantial tax revenues are involved.

Thus, today, more than ever before, the illegal tax protest movement, in our opinion, poses a threat to our country's voluntary compliance tax system. Like the subterranean economy, of which it is a part, the movement apparently continues to gain followers. We attribute this, in part, to the visibility of protest leaders and activists, and their "sales" approach. As taxpayers who are complying with the laws hear of others who reportedly realize financial benefits by not complying, they too may be less inclined to carry the tax burden for those who do not pay.

ILLEGAL TAX PROTEST SCHEMES

Over the years, illegal tax protesters have developed various complex and sophisticated schemes to evade or reduce their taxes, and the courts have denied the legality of many such schemes.

^{1/}The sampling error for this and other key figures throughout the statement is shown in appendix X.

However, as shown in appendix IV, the "constitutional," "family estate trust," and "church-related" schemes have been the most popular in recent years. Together, these schemes comprised about 80 percent of all protest returns identified by IRS in 1980.

We would now like to discuss each of these and other schemes in more detail.

Constitutional scheme

The constitutional scheme is one of the oldest and most frequently used protest approaches. In 1980, it was used in connection with about 37 percent of the protest returns IRS identified.

Generally, these protesters claim that any payment of tax or providing of tax return information violates their constitutional rights, and they cite the 4th, 5th, and 16th amendments. They file an essentially blank income tax return and thereafter refuse to furnish information to IRS. In fact, many constitutional returns are so incomplete that IRS does not consider them to have satisfied the filing requirements and treats them as non-filer cases.

As an example of a constitutionally based argument, persons may claim they are providing no income information because to do so would violate their 5th amendment right against self-incrimination. The Supreme Court held as early as 1927, however, that a taxpayer could not refuse to file a Federal income tax return on the basis of 5th amendment protection. Similarly, protesters assert that the internal revenue laws constitute a taking of property in violation of the due process clause of the 5th amendment. The courts have also denied this claim, stating that "It is now well settled that the income tax laws are not unconstitutional under the due process clause of the 5th amendment."

Family estate trust scheme

The family estate trust scheme, which is over 30 years old, has become the second most popular scheme. It was used in connection with about 26 percent of all the protest returns IRS identified in 1980.

Under this scheme, a person purchases a "trust package" from a promoter. All personal assets (the estate) are then assigned to the trust, and any personal earnings become trust revenues. The promoters misrepresent that (1) a grantor can assign his or her income to either another person or a trust to escape taxation, and (2) substantially all the grantor's living expenses may be deducted on the trust's fiduciary income tax return as business expenses.

Under this scheme, the trust pays many personal expenses of the grantor, such as housing, medical, automobile, and interest expenses. Any remaining trust income is paid to the grantor, who is a trust beneficiary; or the trust income can be divided among several beneficiaries, such as the grantor's minor children who have little or no income. The taxpayer files a form 1041 showing these transactions and a form 1040 return showing any distributions from the trust as income. Our review showed that most users of this scheme attempted to divert personal earnings of between \$15,000 and \$50,000 to the trust.

Several IRS rulings have been published adverse to this scheme, and IRS challenges to these trusts have been upheld in various court cases.

Church-related schemes

Church-related schemes are the newest and, perhaps, the fastest growing of the protest schemes. They were used in connection with about 17 percent of the protest returns IRS identified in 1980.

This scheme has two variations. Under the first, an individual purchases ministerial credentials and perhaps a church charter from a promoter. The person then forms an organization, or becomes a branch of another organization, claiming it to be a tax-exempt church. The person's residence usually houses the "church," and his or her family is usually the "congregation." The person contributes up to 50 percent of his or her income--the maximum allowable--to the church and claims it as a form 1040 deduction, substantially reducing taxes. The church's revenue is used to pay the person's living expenses, such as food, automobile, and housing.

Under the second variation, a person takes a vow of poverty, pledging to obey the orders of the church. The orders, in essence, generally require a person to retain his or her current job and continue his or her existing lifestyle. The person may file a form 1040 claiming income, but then takes an adjustment against gross income for an equal amount. This adjustment eliminates any tax liability. Some protesters show no financial data, stating that they are not required to pay taxes as ministers under a vow of poverty.

An estimated 67 percent of the church-related cases in the three districts we reviewed involved an audit of a church's

tax-exempt status. Another 28 percent of the church-related cases involved large contribution deductions, and the other 5 percent involved vow of poverty claims.

When IRS has successfully disallowed a form 1040 deduction or adjustment under this scheme, it has done so on two general premises. First, the internal revenue laws require that to be exempt from taxation, qualifying religious organizations must be organized and operated for religious purposes and not serve private interests. Second, contributions to an organization are not deductible when made with the expectation of receiving some commensurate benefit in return.

False W-4 scheme

Since 1974 the filing of a false Form W-4, Employee's Withholding Allowance Certificate, has become more common and is often used by illegal protesters in conjunction with another scheme. It is also widely used by other persons for different reasons. We will elaborate on this later when we discuss IRS' Questionable Form W-4 Program.

Under the false W-4 scheme, an employee claims excessive withholding allowances or complete exemption from withholding so that little or no Federal income taxes are withheld by the employer. Later, the employee may either underreport income, refuse to pay the difference between taxes withheld and due, or not file a return at all, thus creating a collection problem for IRS.

This scheme usually starts with a few employees and expands as others learn that their counterparts take home more money for

doing the same work. For example, very recently, about 3,500 General Motors autoworkers in Flint, Michigan, primarily at the urging of two leaders, filed questionable form W-4s. The scheme has even been used by Federal employees and municipal employees, such as policemen and sanitation workers.

In 1980, IRS included in its Illegal Tax Protester Program 937 cases in which individuals filed false form W-4s that IRS determined were protest-motivated. However, this figure should not be construed to be a true indicator of the number of protesters who filed a false form W-4 that year. It is probably understated because for the first 3 months of 1980, employers were not required to send IRS questionable form W-4s. Also, IRS' new program had not progressed to a point where IRS could effectively determine how many false form W-4s were filed by protesters.

Fair market value scheme

The fair market value scheme, which is seldom used, involves taking a deduction for the declining value of the dollar, thus substantially reducing taxes. The tax court has upheld IRS' position that such a deduction is neither provided for nor authorized by the Internal Revenue Code or regulations.

Gold/silver standard scheme

Under the gold/silver standard scheme, which is also seldom used, protesters argue that Federal Reserve Notes do not constitute income because they are not redeemable in gold or silver. They further argue that Federal Reserve Notes are not legal tender. In most cases, the protester will file a blank return with supporting arguments attached. These arguments have been consistently rejected by the courts as being frivolous and without merit.

Protest adjustment and non-payment
protest schemes

The protest adjustment scheme involves the use of an unallowable deduction, adjustment, or credit based on philosophical objections to the use of tax money for certain Government programs, such as defense or foreign aid.

The nonpayment protest scheme involves correctly computing the tax, but refusing to pay the balance due on the basis of philosophical objections.

Federal courts have held in numerous cases involving these schemes that there is no constitutional right to refuse paying income taxes because the funds might be used for Government programs that the taxpayer opposes.

We would now like to discuss the adequacy of IRS' efforts to deal with the growing illegal tax protest movement.

IRS EFFORTS TO DETECT AND DETER
TAX PROTESTERS NEED IMPROVEMENT

In 1978 IRS implemented a nationally coordinated program to detect and deter illegal tax protesters. It designated the program as one of its priorities and has spent increasing amounts of its compliance resources annually in an attempt to curb the movement. IRS identifies more illegal tax protesters each year and has had some success in obtaining convictions against important protest leaders and in bringing protesters into compliance.

Despite its successes, IRS efforts have been hampered in part because of protester tactics that tend to frustrate and

delay IRS compliance efforts. However, IRS could improve the management of its overall efforts against protesters. For example, IRS' detection procedures are limited primarily to identifying those who choose to file a protest return or otherwise notify IRS of their protest. Moreover, weaknesses in IRS' procedures allow certain protesters who do file a return or other documents to elude detection. Thus, IRS' information on the extent of the protest problem is understated, and its understanding of the nature and makeup of the problem is limited.

Once protester cases were identified, IRS, did not always handle them in a timely or effective manner indicative of an effort it has designated as a priority. Rather than designing special procedures for processing protester cases quickly, IRS handled them as part of its regular compliance enforcement efforts. Also, it generally did not select and direct resources at those cases which might have the most deterrent effect, such as ones involving protest leaders and activists. This is not to say that IRS has not pursued some prominent national leaders and successfully prosecuted them.

IRS has made and is making changes to improve the timeliness of its efforts. However, IRS still needs to further improve its procedures for identifying and bringing illegal tax protesters into compliance. In addition, it can have a greater deterrent effect by making other programmatic improvements to better focus its limited resources on the spreading problem. Specifically, IRS should

--develop, with input from the Justice Department, an

overall approach or strategy for dealing with illegal tax protesters; and

--develop better management information.

IRS' illegal tax protester activities

Early IRS illegal tax protest efforts were guided by a myriad of local procedures, primarily in the Western and Southwestern regions where the protest movement originated. In recent years IRS has taken some positive steps to deal with illegal tax protesters nationally. The most significant of these is its Illegal Tax Protester Program which had its origin in September 1977, with the establishment of a task force to study the protester problem. The task force was charged with (1) determining the scope and impact of the protester movement and the effectiveness of IRS' current policies and procedures for dealing with protesters, and (2) developing alternatives for dealing with the problem. In addition to interviewing IRS regional, district, and service center personnel, the task force established procedures for identifying protester returns and documents at service centers and for controlling those returns and documents identified.

IRS issued interim protester program instructions in November 1978 and comprehensive instructions in January 1979. The Assistant Commissioner, Compliance, was designated as the senior coordinating official responsible for implementing and monitoring the program. Functional coordinator positions were also established at the national, regional, and district offices, and at the service centers.

The comprehensive program instructions also implemented the task force's proposed identification and case control procedures. They also added a quarterly reporting requirement to record significant tax protester activities and IRS enforcement accomplishments. The quarterly report, based on field input, contains information on criminal investigations and intelligence collected on the illegal protest movement. It serves as a means for keeping the field informed of new protest schemes. The report also contains a section on resource expenditures by the districts. This resource expenditure information is generally inaccurate and national officials said that they do not rely on it. They were uncertain as to why it was included in the report.

According to IRS, the district offices expended about 236 and 304 staff years on the illegal tax protester program in 1979 and 1980, respectively. This is about 1 percent of the estimated 24,000 average total staff years expended by the districts on all compliance enforcement activities. We estimate, on the basis of the average cost for each occupational specialty, that these resources cost \$6.3 million and \$8.1 million for the 2 years, respectively. These figures do not include the cost of program coordinators and related personnel at the national and regional offices and service centers, because those persons have collateral duties which are not separable for time reporting purposes.

IRS also recently initiated another program--the new Questionable Form W-4 Program--that will help to identify illegal tax protesters. Not all persons who file questionable form W-4s

are illegal tax protesters, but protesters use the technique intentionally to keep tax revenues from the Government. Other persons may file false form W-4s simply for economic or other reasons.

IRS became so concerned about the false filing of form W-4s that it formed a task force in 1979 to develop a program to assure their correct filing. As a result, the Questionable Form W-4 Program was initiated in April 1980. Under this program, employers are required to submit to IRS questionable form W-4s-- those on which employees claim 10 or more withholding allowances or complete exemption from withholding. IRS' service centers process these forms quarterly to identify the false form W-4s and assure that the persons file correct forms.

IRS' procedures for identifying
illegal tax protesters
could be improved

IRS has made positive efforts but further improvements would enable it to more efficiently and effectively detect and deter illegal tax protesters.

Presently, IRS figures on the number of illegal tax protesters are understated. Improvements in IRS' detection system are needed because of the difficulties it has in identifying protesters who do not file tax returns and problems in its procedures for detecting protesters who do file. By improving its detection system IRS would be able to more efficiently and effectively

- determine the extent of the protester problem and identify developing trends,
- identify emerging schemes,

--allocate resources to and investigate the most significant protesters, and

--measure the results and impact of its national program.

"Silent protesters" who do not file returns are the most difficult to detect. In a July 1979 report 1/ on the difficulty IRS has in detecting nonfilers, we estimated that up to 5 million individuals, owing a net total of about \$2 billion in taxes, did not file returns for tax year 1972 and that IRS was only able to detect about 12 percent of these. Not all nonfilers would meet IRS' definition of an illegal tax protester because some persons fail to file due to ignorance or oversight, or other reasons, such as fear of disclosing illegal source income. Neither we nor IRS know how many of the 5 million individuals, including those IRS may have identified, would have met IRS' official definition of an illegal tax protester. However, since protest leaders encourage nonfiling, it seems reasonable to us to conclude that some of those nonfilers were protesters. Through its nonfiler program, IRS did identify an estimated 264 protester cases, or 7 percent, of all protester cases identified in the three districts we reviewed. However, IRS does not know how many protesters were identified through this program nationally.

To the extent IRS effectively implements the recommendations in our July 1979 report, its identification of protest nonfilers should improve. However, even when IRS identifies nonfilers or

1/"Who's Not Filing Income Tax Returns? IRS Needs Better Ways to Find Them and Collect Their Taxes" (GGD-79-69, July 11, 1979).

underreporters, it only includes those persons in its Illegal Tax Protester Program when they voluntarily indicate being protesters. Also, IRS has not ascertained how effective its nonfiler program is at identifying illegal tax protesters and causing them to be placed in the protester program. Rather, IRS relies on its manual provisions which require that the reason for nonfiling be ascertained and also that identified protesters be placed in the protester program.

Unless IRS routinely determines whether those nonfilers and underreporters it identifies are protest-motivated, it will not know the extent and makeup of the protest movement for planning purposes. Nor will it be assured that such protesters receive adequate enforcement attention. Also, some of the most significant protesters may be excluded from IRS' protester program.

Even when individuals file protest returns with IRS, some can be more difficult to identify than others. Tax returns that call attention to protesters' causes are easier to identify than those that resemble ordinary returns. For example, a war protest scheme in which an individual files a return but documents a refusal to pay taxes because of government defense expenditures is easier to identify than a church-related scheme in which an individual takes a questionable deduction for a large church contribution.

Service centers play the primary role in implementing IRS' procedures for identifying tax protest returns. These procedures first come into play during the initial coding of the returns as

they are being prepared for inputting data into the computer. It is important that IRS detect the protest return during this phase; otherwise, it might issue any claimed refund. This could cause a collection problem for IRS if the person filing the return is later identified as a protester who refuses to pay taxes. Protest returns are also identified at the service center by the work units that process claims, approve applications for exemption from social security tax, and screen returns tentatively selected for examination.

IRS service centers detected an estimated 63 percent of the illegal tax protest returns identified by IRS during 1978 and 1979 in the three districts we reviewed. Protesters were identified, to a lesser extent, at the district offices during routine examination and collection activities or through special district projects.

We found several problems with the service center identification procedures. First, we noted that some family estate trust returns eluded detection. IRS procedures require that both the forms 1040 and 1041 be scrutinized by service center personnel during service center processing to identify those returns potentially involving illegal trusts. Thus, the service centers have two chances to identify an illegal trust. However, since the procedure relies on the ability of service center personnel to identify such returns during a high-speed edit process, it can be expected that some returns elude detection. For example, IRS

obtained information from State tax officials and found 128 family estate trust returns that the service center had processed but had not identified as protest returns.

Another problem involves procedures for identifying returns using a church-related scheme. In 1979, IRS studied the effectiveness of its procedure for selecting returns for examination as a backup to the regular identification procedure followed by service centers for identifying questionable large contribution deductions. IRS found that neither procedure was effectively identifying returns with large contributions, even those which had deductions equaling 100 percent of adjusted gross income.

The study was performed by IRS' Western region at the Fresno and Ogden service centers. The region selected 8,730 tax-year 1977 returns where claimed charitable contributions equaled 40 percent or more of adjusted gross income. IRS eliminated 6,870 of the cases because either the return could not be located, it had no tax potential, it involved an apparent traditional church, or it would otherwise eventually be selected for examination.

As of August 1980, after completing 93 percent of the 1,760 remaining cases, IRS had found that 197 returns contained contributions to nontraditional churches. None of these cases had been previously identified by IRS' detection procedures. Also, IRS might have been able to identify more protesters who utilized a church-related scheme had it chosen to examine some of the sample cases it eliminated for various reasons. The study showed that IRS statistics on protesters were understated because of

problems in identifying cases involving large contributions to nontraditional churches. However, the study results did not permit IRS to determine the overall extent to which this scheme was utilized by the study universe because IRS did not review all, or a valid sampling, of the universe of returns. Recently, IRS decided to further study contribution deductions and the use of these deductions by protesters.

Another identification problem resulted from IRS' failure to properly train employees assigned to identify protest documents. At one service center, a procedure which had identified 44 illegal tax protesters in 1978 identified only 2 protesters the next year. We found that IRS designated a different unit to identify protest documents in 1979. However, personnel assigned to this unit were not familiar with case selection procedures.

Weaknesses in IRS' identification procedures contribute to IRS' statistics understating the number of protest returns filed. We reviewed the prior and subsequent year returns for the individuals in our sample to determine whether they also filed protest returns in those years and, if they did, whether IRS counted or even identified them. On this basis, we estimated that in the three districts we reviewed IRS failed to count 273, or 18 percent, of 1,516 prior or subsequent year protest returns filed by these identified protesters. We do not know how many cases IRS may have overlooked in processing the returns of unidentified protesters.

Although not all persons who file false form W-4s are illegal tax protesters, IRS may realize a significant increase in the number of protesters identified through its new Questionable Form W-4 Program. The volume of questionable form W-4s received and those requiring followup have both greatly exceeded IRS' initial estimates.

As shown in appendix V, IRS estimated that in the program's first year about 1 million W-4s meeting the filing criteria would be received from employers. It further estimated that processing these documents would produce 30,000 questionable W-4s requiring followup. However, in the first 6 months of the program, IRS received about 687,000 documents from employers, which yielded about 143,000 questionable forms for followup. Since the program has not been implemented long enough, we do not know how many of the questionable forms IRS will eventually identify as having been filed by illegal tax protesters. However, the chances are good that some of the forms will involve protesters.

Although it is too early to determine how effective the W-4 program will be in identifying protesters, certain aspects of the program could cause IRS problems when dealing with illegal tax protesters identified only through the W-4 program.

First, there is a long time lag between when a person submits a form W-4 to his or her employer and when IRS notifies the employer to disregard that form W-4. In the interim, the employee could retain most of his or her income, thus giving IRS a potential collection problem. One cause for the time lag is that IRS only requires employers to submit questionable W-4s quarterly, thus over 3 months can elapse before IRS sees them.

However, the main cause is the time it takes IRS to process and evaluate the forms. According to IRS, it takes 11 to 19 weeks after receipt to fully process a questionable form W-4. However, at the end of 6 months, IRS had not yet completed work on all of the first group of forms processed. Although some of the delays can be attributed to the newness of the program, the fact that IRS underestimated the volume of cases to be worked by over 376 percent created a resource problem that cannot be quickly remedied.

Until recently a loophole in IRS' Questionable Form W-4 Program regulations was causing problems. The regulations allowed an employee to file additional false form W-4s after IRS had (1) determined the first and subsequent W-4s to be false and (2) directed the person's employer to withhold income tax as if he or she was filing as a single person without dependents. The employers had no authority to turn down subsequent W-4 changes submitted by the employee.

To close this loophole, IRS issued emergency regulations on March 19, 1981, which, among other things, prohibit employers from honoring subsequent form W-4s once a false form has been filed, unless the new form W-4 meets certain criteria. This action should go a long way toward reducing repeated filings of questionable form W-4s--a tactic likely to be tried by illegal tax protesters.

At this time, we are reluctant to make any recommendations regarding the Questionable Form W-4 Program because we did not conduct a comprehensive assessment of the program. A

comprehensive analysis of the program should help IRS decide what additional changes, if any, are needed. In this regard, IRS' Internal Audit Division has initiated a nationwide audit of the program, which should provide a better basis for considering any needed changes.

IRS' efforts to bring protesters into compliance need improvement

Once IRS has identified illegal tax protesters, it has not been as effective as it could be in bringing them into compliance. IRS' effectiveness is somewhat reduced because of the delaying tactics employed by protesters. Cases are delayed during many phases of the enforcement process--some times for extensive periods by the protester and other times by IRS. Too often, protesters continue to file protest returns or become nonfilers. Also, the protest movement continues to grow. This growth continues even though IRS spent an estimated \$14.4 million of its district compliance resources on the program alone over the last two years and has made some changes to improve its compliance efforts. Before IRS can make significant progress in curbing the protest movement, it must demonstrate to the taxpaying public that protesters will be dealt with in a timely manner using the most appropriate and effective enforcement powers available.

We would now like to present the results of our review of IRS' compliance efforts based on a random sample of cases placed in the Illegal Tax Protester Program in three selected districts during 1978 and 1979 and on certain cases involving protesters who were convicted during 1979 of selected criminal tax violations.

IRS' compliance efforts are
untimely and ineffective

It is important that IRS timely convince protest return filers that they cannot evade taxation by using a protest scheme. Failure to convince them will only result in the continued filing of protest returns, which in turn will absorb more IRS resources.

To assess the effectiveness of IRS' compliance efforts against protesters, we considered (1) how successfully it closed cases by assessing and collecting taxes, (2) how long the enforcement process took, and (3) how far open cases had progressed in the process at the time of our review. To measure deterrent effects, we reviewed 1979 tax return information to determine whether persons previously investigated under IRS' protester program voluntarily complied or continued to protest. We also reviewed the extent to which IRS used special compliance measures, such as penalties, to try to deter protesters.

Appendix VI shows that, as of December 1980, IRS had only closed an estimated 1,139, or 29 percent, of the 3,870 cases that were included in the protester program in the three districts during 1978 and 1979. About 2,280, or 59 percent, of the cases remained open, and IRS had decided not to pursue about 451 cases for various reasons. About one-half of the open cases had not progressed past the first compliance phase--examination--where IRS proposes an adjustment to the taxes owed.

Because of the way we drew our sample we could not reach a statistically valid conclusion regarding the types of protest

schemes that took IRS the most time to work. However, our data does indicate that IRS had more success closing cases involving false W-4 and war protest schemes. On the other hand, cases involving church-related, constitutional, and family estate trust schemes were seemingly more difficult to close. Most of the cases still open in examination involved family estate trust schemes.

IRS has no criteria for the length of time a case should normally take to complete. Therefore, for purposes of our review, we arbitrarily considered a case delayed if it was in the same phase for 180 days or more. On this basis, we estimate, as shown in appendix VII, that 2,977, or about 77 percent, of the 3,870 cases in the three districts were delayed in one or more of the compliance phases. Of the 1,139 cases IRS had closed at the time of our review, 858 of them, or about 75 percent, were delayed. In contrast, 1,985 of the 2,280 open cases, or about 87 percent, were delayed. IRS did not pursue the remaining 451 cases.

Next, we analyzed closed cases to determine how long they took in each phase of the compliance process. As shown in appendix VII, closed cases generally stayed in the criminal investigation phase less than 180 days. This is because, after reviewing the case, criminal investigation personnel decided not to pursue the case criminally. The examination phase usually took 180 days or more, and about 41 percent of the examined cases for which we could make a determination took over a year.

The distribution of cases taking more or less than 180 days in both the post examination and appeals functions was generally the same. The average number of days to close a case was 466.

We did not perform a similar analysis on open cases because all work on the cases had not been completed. However, we did determine how long the cases had been open, in all phases, at the time of our review. As shown in appendix VIII, about 84 percent had been open for a year or more, and about 41 percent had been open 2 or more years. Most of the open cases were still in the Examination Division and had been there 1 or more years. Since they were still in the Examination Division, taxes had not been assessed.

One of the best measures of the effectiveness of IRS' compliance efforts is its ability to collect taxes from protesters. IRS has had some early successes at collecting these accounts. IRS had made final tax assessments totaling \$2.5 million on an estimated 1,266 cases in the three districts. It assessed penalties totaling \$251,000 on 1,211 cases. IRS collected \$2.4 million, including interest on all or part of 1,148 cases. These figures include partial payments. In an estimated 391 cases, about \$420,000 had not been collected, and, of this amount, an estimated \$23,000 was presently determined to be uncollectible by IRS.

Collection results to date should not be interpreted as meaning that IRS will have an easy time collecting protester

accounts. It should be noted that protesters were contesting an estimated \$5.7 million in proposed tax assessments at the time of our review. Also, additional taxes are involved in other cases that have not progressed to the point of IRS even proposing an assessment, and most of these protesters refused to provide the necessary records for IRS to complete its examinations. As such, the taxes involved in these cases may be more difficult for IRS to collect.

It should also be pointed out that about \$1.3 million of the \$2.4 million IRS did collect was collected from persons who voluntarily paid after the examination. Most voluntary payments were made by persons using the family estate trust scheme. This is not surprising because, according to IRS, these persons are often not hardcore protesters but rather persons who discover they have been misled by a promoter; thus, they are more willing to pay.

To determine IRS' deterrent effect on those illegal tax protesters it investigates, we reviewed the 1979 tax year filing status for our sample cases. We estimate that 1,787 persons in the three districts filed a nonprotest return, 567 filed a protest return, and 928 did not file. In the remaining 588 cases, information generally was not available to permit us to evaluate their filing status. Although a statistically valid conclusion could not be reached, indications are that persons using the family estate trust scheme were more likely to become compliant. In contrast, persons using constitutional, church-related, and

gold/silver schemes were more apt not to file. Thus, although IRS definitely had a deterrent effect on some protesters, many others remained protesters, including a substantial number who resorted to nonfiling.

To further evaluate IRS' pursuit of nonfiler protesters, we examined 10 illegal tax protester nonfiler investigations which one IRS district had closed on the basis that expected revenue did not warrant the cost. Although this revenue yield criterion may be generally valid in dealing with the average taxpayer, we question its use in deciding not to pursue nonfilers who are also illegal tax protesters. In 4 of the 10 cases, income information available in IRS data files showed that the investigation was not as thorough as it should have been. For example, one nonfiler had income of about \$15,000 which would have yielded about \$2,500 in taxes alone had IRS not decided to drop the case.

We also reviewed whether, as a deterrent measure, IRS imposed penalties against protesters. We found that IRS examiners had appropriately proposed penalties against protesters. A penalty against protesters was proposed in an estimated 1,999 of 3,870 cases in the three districts. About 1,492 of these involved negligence penalties--a penalty imposed against persons who fail to exercise due diligence when preparing their tax return and computing their tax liability--and about 507 cases involved various other penalties. In those instances in which IRS did not assess penalties, we obtained the reasons why from the case files or from discussions with IRS personnel. We found

no instances in which IRS erred by failing to consider an appropriate penalty against the protester.

None of the three districts had assessed a preparer penalty even though paid preparers were involved in 199 of the 3,870 cases in the three districts. About 76 percent of the returns they prepared involved family estate trusts. These protesters, in effect, paid for poor advice and perhaps purchased it from a scheme promoter. Considering IRS' opinion that the users of the family estate trust scheme are often misled, we question the timeliness of and the limited use IRS has made of the preparer penalty. IRS has recently initiated some efforts against return preparers. IRS officials in one district said they were developing some preparer penalty cases, including a criminal investigation against a major promoter of the family estate trust scheme. It seems that IRS should have been more concerned with penalizing such preparers sooner.

As a separate test of IRS' effectiveness in deterring illegal tax protesters, we reviewed the return filing and taxpaying records of 71 of the 143 protesters convicted of criminal tax violations in fiscal year 1979. Our objective was to determine how successful IRS was in securing delinquent tax returns and collecting taxes due from convicted persons and whether such persons voluntarily met their subsequent year tax obligations. Of the 71 cases we reviewed, 39 of the protesters were convicted of failure to file and 32 were convicted of filing false form W-4s. Individuals convicted of failure to file received an average prison sentence of 15.5 months, reflecting the more serious

nature of the violation, while false form W-4s filers received only 6.5 months. The most severe sentence for each violation, respectively, was 8 years in prison, with 5 years suspended, plus 5 years probation; and 2 years in prison with 1 year suspended, plus 5 years probation. The average probationary sentences were 32.6 months and 26.2 months, respectively.

IRS secured tax returns from 44 of the 71 convicted protesters. It collected almost \$93,000 from 20 of the 44 protesters, and the other 24 still owed about \$133,000 at the time of our review. Taxes were also due in the 27 cases in which IRS had not secured a tax return. However, we do not know how much taxes the individuals involved in these cases owed because neither the taxpayer nor IRS had proposed an assessment.

These results raise a potential problem in that a requirement to file returns and pay any taxes owed is often a condition of probation for individuals convicted of criminal tax violations. It is possible that the terms of the probation are not being met. IRS has a procedure whereby Criminal Investigation Division personnel are to coordinate with Collection Division personnel and in turn with probation officers. All such cases are supposed to be flagged until terms of the probation are met. However, national office officials are not kept apprised of the results of the collection attempts. Therefore, they do not know why the delinquent returns have not been secured or whether the procedure is working as it should. We did not determine the effectiveness of this procedure or the extent to which

IRS and the Justice Department effectively coordinated on these matters because of the time it would have taken to review the records spread throughout various district offices across the country.

Factors hindering IRS' compliance efforts

We sought to find reasons for the delays in IRS' processing of protester cases and to determine whether changes could be made to improve IRS' timeliness and effectiveness. Often, neither case files nor IRS officials could provide the reasons for delays.

Our analysis of sample cases in the three districts showed that many delays were caused by protesters, who were generally uncooperative and took advantage of the system to prolong IRS' inquiry. Most often, protesters would either not timely provide the necessary records or refused to talk to IRS. Protesters taking advantage of statutory or regulatory provisions, such as the summons provisions of the 1976 Tax Reform Act, and other factors also caused many delays. But IRS also contributed to delays due principally to (1) difficulties in locating tax returns and assembling other tax information from its files, (2) competing priorities and heavy caseloads, and (3) the need to do additional work in developing cases.

There may be an additional reason for delays in processing church-related cases due to the unusually sensitive nature of the legal issues involved. They can involve, for example, the difficult determination of whether a "church" is organized exclusively for religious purposes, and thus afforded benefits

by the internal revenue laws; or whether it is solely a tax evasion scheme. Since religious organizations also have the constitutional protections of the 1st Amendment, this determination is considerably more complex than other protester schemes.

Appendix IX shows our projections of the incidence of delays caused by various factors in protester cases in the three districts. We could not determine how much delay each factor caused because the records needed for such an analysis were not available.

We obtained further information on the causes of delays from IRS officials when we tracked our sample cases through the various compliance phases and from IRS studies. One overriding cause was IRS' policy to not single out protesters, or even protest leaders, in order to minimize the potential for charges of harrassment. Such a policy does not recognize that protesters are a special compliance problem. Also, rather than establishing special procedures for protester cases, IRS chose to handle them within its regular compliance system--a system designed to deal with generally cooperative and compliant taxpayers.

More importantly, the program suffers from a lack of authoritative management direction and attention at all organizational levels within IRS. Currently, IRS' Assistant Commissioner for Compliance, 7 Regional Commissioners, and 58 District Directors are charged with authority over and responsibility for the Illegal Tax Protester Program, as well as other tax administration programs and activities. These top officials cannot

reasonably be expected to direct, control, and monitor daily program operations. Rather than designate a program manager at each level, IRS established coordinator positions in each of its compliance divisions and its Exempt Organizations Division at each organizational level. None of the division coordinators have any authority over the protester program except within their respective divisions. Overall program direction and attention is important in the tax protester program because cases often cross two or three functional lines and the case becomes subject to the normal managerial and supervisory priorities and controls within each function.

What can IRS do to improve its efforts against protesters? Organizationally, IRS may need to include tax protester cases in a high priority special compliance program along with other special compliance problem cases such as abusive tax shelters. A person at the national and regional office levels and especially at the district level could be given cross functional authority to assure that protesters and other special compliance problems receive adequate agencywide attention and support. These persons at each level could be given overall authority and responsibility for managing and directing special compliance programs, including IRS' illegal tax protester activities. Our views in this regard are based, partially, on similar administrative problems noted in our work on IRS' abusive tax shelter program.

Administratively, IRS can make several procedural changes which should increase its timeliness and effectiveness in handling illegal protester cases. Such changes should be based on

the recognition that illegal protesters are generally not voluntarily compliant taxpayers, but rather persons committed to thwarting the tax administration system.

First, to speed up the processing of cases at the district level, IRS could require its service center personnel to do an adequate records search and accumulate a case file before forwarding the case to the district. This should include querying all available data sources within IRS for the present and prior tax years, including the information documents and questionable W-4 data files. Such data, together with tax returns, could be used to make a final decision as to whether a case should be referred to the appropriate district for action. The data could then be forwarded to district personnel responsible for working the case, thus minimizing the extent to which they would need to develop and query for additional data. Using the W-4 data file should also help district personnel more timely identify the illegal tax protesters' employers from which to obtain sufficient information to quickly make a proposed tax assessment.

One IRS region noted that delays were caused by the intermingling of protester returns with other nonpriority returns when returns were shipped from service centers to district offices. Requiring special handling of shipments of illegal tax protester cases from service centers to the district offices should help solve this problem.

To expedite the tax assessment process, IRS should increase its use of the technique of proposing tax assessments based on a substitute return when a protester refuses to cooperate. The

opportunity for increased use lies with wage earner protester cases wherein IRS can identify the protesters' employer from the questionable W-4 or information return data files.

IRS could particularly expedite the examination and proposed assessment phases on family estate trust cases. Once IRS has the forms 1040 and 1041, it could compute a proposed assessment on the basis of the amount of wages or salaries diverted to the trust. It could then mail the proposed assessment in the form of a 30-day notice advising the individual that two options are available with regards to certain deductions claimed on the form 1041. The first option would be to provide the necessary support for the claimed deductions within the 30-day period so that IRS could recompute the person's income tax liability. The second option would be to file an amended income tax return or other claim detailing those form 1041 deductions which the person claims are allowable in computing his or her individual income tax liability.

One district did make proposed assessments based on income diverted to the trust and ignored the deductions claimed on the form 1041 when the protesters did not timely provide records. An Examination Division person in another region agreed that this procedure would expedite the process. He said that such a procedure had been tried in his district, but that Appeals Division personnel rejected the cases and sent them back to the Examination Division to be further developed to include appropriate form 1041 deduction adjustments. An IRS national office Examination Division official agreed with our suggested procedure

and said that guidelines were recently revised accordingly. However, the revised guidelines do not explicitly describe our suggested accelerated procedure.

IRS has tried to accelerate the initiation of collection action on protester accounts by using its accelerated delinquent account program. Protester accounts exceeding certain dollar criteria are supposed to be processed through its accelerated delinquent account program. Also, such accounts are supposed to be assigned to the more experienced revenue officers. If the procedure works as intended, the larger dollar taxpayer accounts should be expedited through the collection notice process. Those accounts below tolerance, however, will not be expeditiously pursued.

Revisions regarding the summons provisions of the 1976 Tax Reform Act could also reduce delays in handling protester cases. In 17, or 10 percent, of our sample cases, IRS had issued a total of 51 summonses to obtain records which protesters had refused to furnish. Nationally, IRS issued 937 summonses on illegal tax protester cases for the 6-month period ending September 30, 1979. IRS does not have figures readily available on the number of times protesters attempted to block the summonses by intervention. However, according to IRS, protesters frequently use this tactic for delaying purposes.

Although taxpayers have a legal right to temporarily delay a summons through intervention, the sincerity of protesters' actions with regard to summonses is questionable because, according to IRS, protesters seldom appear in court to argue why the

summons should not be enforced. According to IRS, protesters' motives are more directly related to tying up IRS' resources and being uncooperative. Administratively, IRS could establish criteria for how long it should wait for known protesters to provide records before initiating the summons process. This would ensure that some positive steps were being taken to expedite protester cases. Legislatively, as we have expressed in several prior reports and testimony, the summons provisions of the 1976 Tax Reform Act need to be revised to require a taxpayer to expeditiously show cause in writing to a court why a summons should not be complied with.

In addition to improving its procedures for identifying and handling protester cases, IRS can make further programmatic improvements to better focus its limited resources on a spreading problem and have a greater deterrent effect. These relate to planning, management information, and protester-related publicity.

IRS needs an overall plan for
dealing with illegal tax protesters

Presently, IRS has no overall approach or strategy for illegal tax protesters that attempts to maximize deterrent effect while consuming a minimum of resources. From a policy standpoint, IRS has established protesters as one of its major priorities. Once identified, however, most protest returns are processed as part of the regular compliance enforcement process at the districts.

In recent years, the illegal tax protester problem has continued to grow, and IRS has devoted increasing resources to it--about 1.3 percent in 1980. At the protest movement's current

growth rate, IRS may have to expend about 2 percent of its district compliance resources on the problem this year and even more next year to work the increasing number of protest returns. We estimate it expended almost \$14.4 million over the last 2 years on illegal tax protester cases. Although this may not seem like much, the problem continues to grow, and IRS has not been as effective as it could be in bringing protesters into compliance. Before IRS can be more effective it needs to plan how to better spend its current resources so as to maximize deterrent effect. Even with an effective plan, IRS may need to spend substantially more resources until the movement is effectively countered. The protest movement, because of its high visibility and potential for spreading, poses a threat to the voluntary tax system.

Because of the many other compliance problems confronting IRS, continued growth in the number of illegal tax protesters will only place an added strain on IRS' limited compliance resources. Of equal concern are the constraints on the resources of the Justice Department and Federal court system, both of which play a role in criminal and civil litigation against protesters. Thus, it is essential that IRS have a planned approach so that it has a basis for assigning its resources and expediting those cases which will have the most deterrent effect on the protester problem. Such a plan should also provide a basis for measuring program results and making appropriate changes.

In a November 1979 report 1/ we discussed the elements of and need for good planning in the criminal tax area and the need for IRS to coordinate with Justice at the national and local levels because of its prosecutive role. The two agencies have attempted to improve overall coordination in the criminal tax area although the number of Justice declinations of IRS cases continues to rise. Recently, they have coordinated in developing criminal tax cases for some of the more sensitive and growing illegal tax protest schemes.

For example, because of sensitive constitutional issues surrounding church-related schemes, IRS agreed to develop several high-quality investigations as test cases while Justice agreed to provide general legal guidance and legal support. Pending the outcome of these first cases, IRS also agreed to seek civil remedies in church-related cases and refrain from routinely referring them to Justice for criminal prosecution. As a result of this coordinated effort, in February 1980, Justice forwarded 8 of 14 test cases involving church-related schemes to grand juries for criminal investigation or the initiation of criminal prosecution. Justice declined prosecution on the remaining six cases. As of May 14, 1981, criminal indictments had been returned in four cases, and Justice obtained the first two convictions in a

1/"Improved Planning For Developing and Selecting IRS Criminal Tax Cases Can Strengthen Enforcement of Federal Tax Laws"
(GGD-80-9, November 6, 1979)

jointly-tried case. In addition, IRS has won all of the 25 church-related cases pursued civilly before the Tax Court.

With the recent rise in false W-4 filings and IRS' establishment of the Questionable Form W-4 Program, IRS and Justice began to coordinate more closely on W-4 related cases to determine which should be pursued criminally as opposed to administratively through IRS' Questionable Form W-4 Program. This was necessitated because Justice no longer allowed IRS to take W-4 cases directly to the local U.S. Attorney. Justice has worked with IRS to allow certain W-4 cases to be pursued criminally. For example, on April 14, 1981, on the basis of information developed by IRS, Justice obtained criminal indictments against two leaders involved in the false W-4 filing incident in Flint, Michigan.

We believe IRS and Justice are moving in the right direction, especially in terms of efficiently and effectively using criminal proceedings to combat the protester problem. However, as the protester problem intensifies, we believe it will become increasingly essential for IRS and Justice to have an overall coordinated plan for dealing with illegal tax protesters. We believe IRS, with input from Justice, can use the techniques discussed in our November 1979 report and the recent experience gained in coordinating on church-related and W-4 matters as a basis for developing such a plan. The plan, which should have the input of local IRS program coordinators and U.S. Attorneys, should provide a framework for making key program decisions. These decisions include:

--To what extent should resources be directed at proactively identifying and pursuing leaders and activists as opposed

to protesters identified through IRS' service center pipeline and other sources? Perhaps cases deemed not to have as much potential deterrent effect could continue to be processed as part of IRS' normal compliance enforcement process.

--What approach will provide the most deterrent effect for each of the various protest schemes, and what aspect of the protest problem should receive the most emphasis?

--Generally, when and against what types of protesters should criminal versus civil proceedings be used to enforce compliance? Because of the similarity in the development of civil and criminal litigation for some protest schemes, such as church-related, Justice's input regarding a criminal/civil strategy is important.

IRS cannot efficiently and effectively plan, allocate resources, and make other strategic decisions regarding its Illegal Tax Protester Program without adequate management information.

IRS needs better management information

Presently, IRS relies principally on its fragmented compliance related information systems to manage its protester efforts. This is supplemented with information accumulated manually by IRS' many illegal protester program coordinators or by computers at service centers. Headquarters officials from each of IRS' compliance divisions stated that their respective management information systems are adequate for the management of their division's activities. None of the officials, however, could speak for the overall program because there is no

single program manager, and no overall management reports are being generated.

IRS' current management information system has several shortcomings. First, it does not provide adequate staff and calendar time information. Although IRS accumulates total staff time charged to the national program, we identified some problems with the accuracy of this data. For example, some of our sample cases had no record of the time charged to them by some of the divisions that worked on them. Also, although IRS keeps track of the age of the cases in each division as part of its regular compliance information system, it has no cumulative data showing the length of time protester cases were open in IRS as a whole. Moreover, none of the information is available by scheme or type of protester, such as leader, activist, or follower. Therefore, IRS does not know how long it takes to work illegal tax protester cases overall or to what extent it is expending its resources on various schemes and types of cases.

Second, IRS does not have sufficient information on the results of the protester program. It generally does not know the (1) aggregate results of its enforcement efforts, particularly civil actions, taken against protesters and (2) the extent to which protesters are brought into compliance by filing required returns and paying taxes due. Furthermore, no information is available by type of scheme or protester involved. Neither does IRS have statistics on the subsequent voluntary compliance history of identified protesters, a needed measure of the deterrent value of the program.

Third, IRS' system is not adequate for tracking protester cases from division to division or for reconciling service center figures on the number of cases identified with district figures on the number of cases being worked. We found several cases in the three districts we visited which had been closed by the Examination Division but not picked up statistically by the Collection Division. Tracking the cases is important from a management standpoint because our sample results showed that most illegal tax protester cases pass through two or three IRS divisions before they are closed. We also found several illegal tax protester cases identified in the districts which were not placed in the protester program at the appropriate service center; thus they were not included in IRS' program statistics.

In January 1979, IRS introduced a tracking form to record, for each compliance phase, how a protester case progressed, what problems were encountered, the disposition of the case, and the time charged. This form would have provided a complete history on the case for local managers to use. Also, if the information were summarized and analyzed, it could be used for overall program management purposes. Unfortunately, the form was seldom prepared and, when it was, management neither accumulated nor used the information. IRS plans to eliminate the form and continue to rely on that information collected by its present management information systems. IRS national office officials representing various compliance functions contended that the form provided little additional useful management information other than that presently accumulated, and supported its elimination.

We believe, however, that the form would have been useful in collecting information for managing and evaluating the overall Illegal Tax Protester Program.

Additional opportunities for IRS to use
the public media in dealing with illegal
tax protesters

Considerable press coverage has been given to protest leaders in recent years as they market their various schemes. According to IRS, its Public Affairs Division has devoted a majority of its resources to the protester program during this same time period. Their efforts were primarily directed toward providing responses to the media and developing a package of information on each scheme that could be used by district office officials when responding to local media requests or issuing press releases.

Such efforts should inform the public about (1) IRS' position on the various schemes and (2) criminal and civil actions IRS has taken against persons who previously attempted to use a particular scheme. However, such efforts will not necessarily counter specific false claims made by protest leaders.

No empirical data exists to show how effective IRS publicity efforts have been in convincing other persons not to become protesters or the extent to which protest leaders' false claims cause other persons to become protesters. Available evidence does show that more people become protesters each year and the movement is growing.

IRS' illegal tax protester task force members pointed out in 1979 that the credibility of the illegal tax protest leader is a principal force in the expansion of the protest movement. The

task force also pointed out that, in many cases, protest leaders make false claims about their personal tax situations and IRS' dealings with them. During our review, district personnel associated with the Illegal Tax Protester Program continued to express concern about the false statement problem and the restrictive nature of Internal Revenue Code provisions which limit IRS' ability to disclose personal tax data.

Section 6103(k)(3) of the Internal Revenue Code allows IRS to disclose taxpayer return information or any other information necessary to correct misstatements of fact, provided such disclosure is authorized by the Joint Committee on Taxation. IRS national office officials told us that IRS had never attempted to obtain the Joint Committee's approval on a protest related case because IRS district offices have not asked the national office to do so as yet. These officials also expressed some skepticism about the workability of this Code provision because they viewed the approval process as burdensome and time consuming.

We recognize that an effective IRS rebuttal of a protester's false claim would require that it be timely. However, we question whether IRS' reasons are adequate justification for not at least trying to obtain Joint Committee approval in selected cases. In those situations where protesters make false statements, IRS should collect information showing what false statements were made, their potential impact, what the facts are from IRS' standpoint, and how disclosure by IRS of the tax information would clarify the situation. Then, Joint Committee approval could be sought to allow IRS to make a future disclosure about these protesters' previous false

claims. Unless IRS tries the Joint Committee approval process, it will never know its usefulness in deterring other persons from becoming protesters.

CONCLUSIONS AND RECOMMENDATIONS

Faced with a growing illegal tax protest movement, IRS has taken some positive counter measures, including implementing a nationwide program to identify and investigate protesters. Although IRS has achieved some success under this program and its related Questionable Form W-4 Program, IRS can improve its efforts to detect and deter illegal tax protesters. Too many protesters escape detection, and IRS' sometimes untimely compliance efforts do not always cause protesters to become compliant.

Although the number of known protesters in comparison to the taxpaying population is not overwhelming, the protest movement is growing. It represents a threat to our Nation's voluntary compliance tax system because of the visibility of tax protest leaders and activists and their "sales" approach. Therefore, it is essential that IRS demonstrate to protesters and to the taxpaying public that it can and will aggressively pursue protest cases to a timely conclusion, thus assuring that these persons shoulder their portion of the burden in accordance with existing laws. Otherwise, protesters will continue to file protest returns or become nonfilers and presently compliant taxpayers will possibly become protesters.

Due to various limitations and weaknesses in IRS' detection system, its information on the extent of the illegal tax protest problem is understated. Also, its understanding of the nature

and makeup of the problem is inadequate for efficiently and effectively allocating resources to the most significant protester cases and for measuring program results and impact. IRS' new Questionable W-4 Program should help IRS identify more protesters. However, IRS could identify even more illegal tax protesters through its nonfiler program, annual delinquency checks, and better identification of returns with questionably large contribution deductions.

IRS has not handled illegal protester cases as timely or effectively as might be expected of a priority effort. Until recently IRS had not developed special procedures to cope with the factors that caused delays in dealing with this special compliance problem. Instead, IRS handled protesters as part of its regular compliance enforcement system which is designed to deal with the average, generally compliant, and cooperative taxpayer. Yet, our sample results showed that protesters often abused the voluntary compliance system through such delaying tactics as withholding records; challenging IRS' summonses, short of appearing in court; and requesting appeal or tax court hearings, primarily for the purpose of absorbing IRS' resources and delaying the assessment and collection of taxes. As a result, many cases take from 1 to 3 years for IRS to complete, collection is delayed, and deterrence from future noncompliance hindered.

Several other factors reduce IRS' effectiveness in dealing with protesters:

--In selecting and processing protester cases, IRS does not generally distinguish cases by their potential deterrent

significance. With the exception of criminal cases, leaders and activists are often handled routinely with other, perhaps less significant cases.

--Organizationally, IRS is not structured to ensure that protester and other special compliance cases which cross functional lines get adequate management attention and support.

--IRS does not have an overall approach or strategy for dealing with protesters. A plan is necessary to ensure that Government resources are used efficiently and have the highest deterrent effect possible.

--IRS' management information system is not sufficient for monitoring protester cases and measuring program results.

IRS can take several actions to improve its efforts to identify and bring illegal tax protesters into compliance.

To improve its detection procedures and information on the overall extent and makeup of the tax protester problem, we recommend that the Commissioner of Internal Revenue direct IRS officials to:

--Routinely determine whether persons detected through IRS' nonfiler program are protesters and assure that they are pursued accordingly.

--Develop a service center computer program to identify returns with large charitable contributions and establish procedures for questioning those contributions before making refunds or accepting the return as filed.

--Provide appropriate personnel with sufficient training on protester identification procedures.

--Conduct an annual delinquency check on previously identified protesters to verify that filing requirements were met and the proper tax assessed and paid.

To increase the timeliness and effectiveness of compliance enforcement efforts against illegal tax protesters, we recommend that the Commissioner institute the following changes.

--When service centers identify a protester, they should accumulate a file of all pertinent data from sources within IRS, including information documents, questionable W-4s, and prior returns. In addition to being used to make a final referral decision, the file could be referred to the district and help expedite the case at that level.

--Shipment of protester cases from service centers to districts should be specially handled to reduce lost time.

--When protesters are uncooperative, IRS should prepare and process substitute tax returns based on available information, such as employer-provided information.

--Explicit guidance should be provided to examination and appeals personnel regarding how family estate trust cases should be expeditiously examined and processed.

--When a protester case involves a paid preparer, IRS should expeditiously assert, where appropriate, a penalty against the preparer.

--IRS should establish waiting time criteria for issuing summons to tax protesters.

To improve the overall efficiency and effectiveness of its Illegal Tax Protester Program, we recommend that the Commissioner:

- Establish working groups in each district division to handle protester and other special compliance cases and designate one district official with the responsibility and authority for cutting across functional lines to ensure that such cases receive adequate and expeditious attention. Similar positions should be established at the national and regional office levels to ensure that the protester program and other special compliance programs receive the attention they need.
- Develop, with input from the Justice Department, an overall plan for dealing with illegal protesters.
- Develop more comprehensive management information for use in planning, allocating resources, and making other strategic decisions relative to the illegal tax protester efforts.
- On a test case basis, seek Joint Committee approval under Code section 6103(k)(3) to disclose taxpayer return information or any other information necessary to correct misstatements of fact.

Finally, we reaffirm our past position concerning the need for the Congress to revise the summons provisions of the 1976 Tax Reform Act by requiring taxpayers to expeditiously show cause to a court for not complying with a summons. This would prevent

protesters from delaying cases by failing to provide IRS with records until shortly before a summons enforcement court appearance date arrives.

REVIEW OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our review were to determine the nature and extent of the illegal tax protest problem and to evaluate the effectiveness of IRS' efforts to deal with the problem. To accomplish these objectives, we reviewed:

- IRS procedures for identifying illegal tax protesters and processing and controlling cases that IRS placed in its program.
- IRS' management information system as it pertained to illegal tax protesters.
- Coordination between IRS and the Department of Justice's Tax Division.

We also interviewed various IRS national, regional, and district level and service center officials responsible for coordinating illegal tax protester related activities.

To assess IRS' effectiveness in expeditiously bringing illegal tax protesters into compliance, we initially selected a random sample of 222 cases. The sample was taken from a universe of 4,192 illegal tax protester cases which were identified in 1978 and 1979 in IRS' Des Moines, Los Angeles, and Manhattan districts. We finally analyzed 167 of the sample cases. Sixteen cases were dropped because IRS either could not locate or could not provide complete information on them. To eliminate any bias, we also dropped another 39 cases because they were erroneously placed in the protester program. That figure, when projected, reduced the universe in the three districts to 3,870 valid illegal tax protester cases.

In analyzing the 167 sample cases, we assessed IRS' effectiveness in terms of its

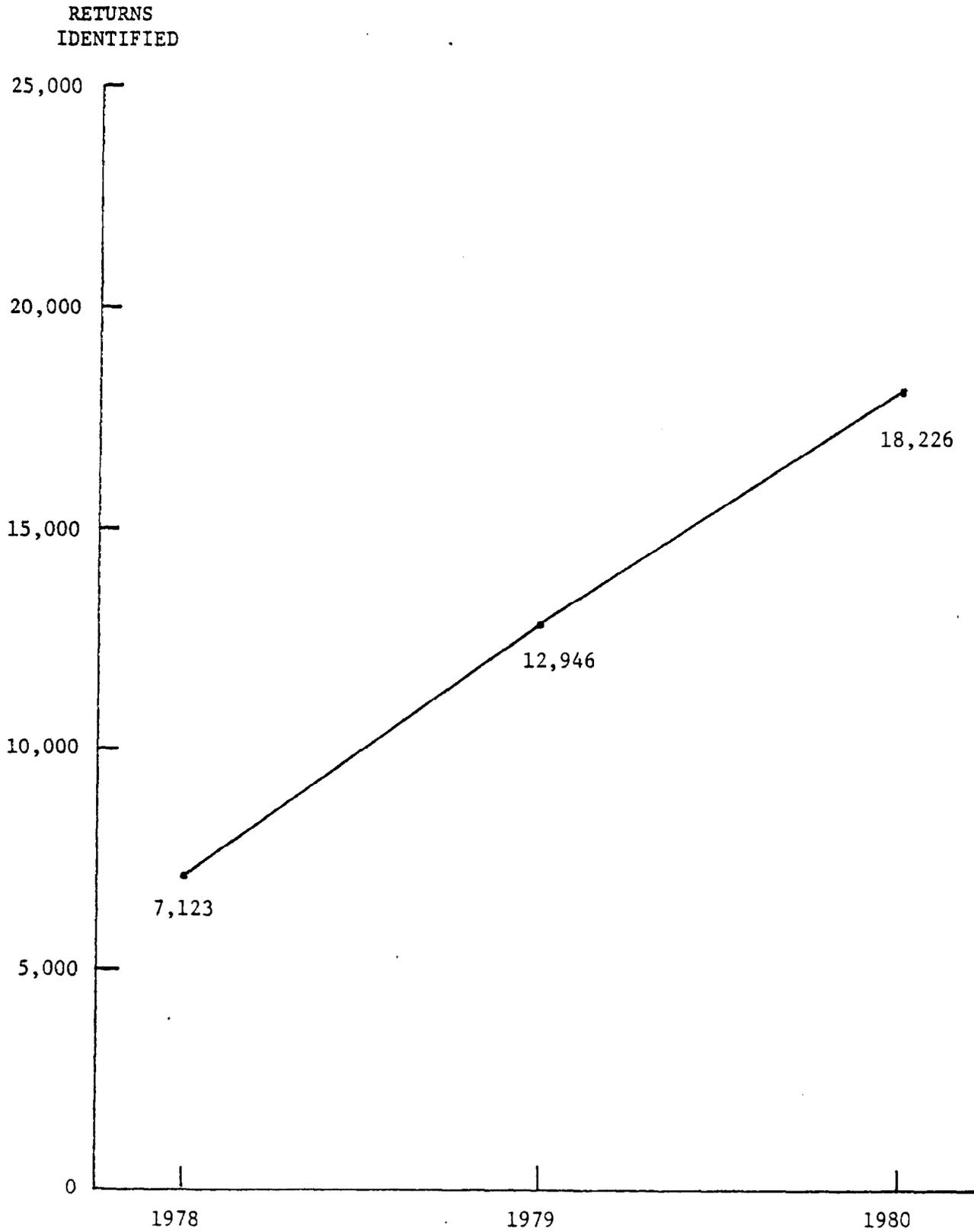
- timeliness in processing cases,
- success in getting protesters to file required returns and pay their taxes, and
- success in preventing future noncompliance by protesters.

In performing our analysis, we were also concerned with the differences between types of schemes used by protesters, the varying problems they posed for IRS, and IRS' success in dealing with those problems. Sampling error statistics for selected figures contained in this statement are shown in appendix X.

We also reviewed the tax return filing and payment records of 71 protesters that were convicted in fiscal year 1979 for failure to file tax returns or for filing a false form W-4.

In addition to the three IRS district offices, we performed work at IRS' national office in Washington, D.C.; its Atlanta, Chicago, Dallas, New York, and San Francisco regional offices; and its Fresno, Brookhaven, and Kansas City service centers.

Illegal Tax Protester
Returns Identified By IRS
1978-1980



Illegal Tax Protester Returns
Identified By IRS Service Centers
1978-1980

<u>Service Center</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>Percentage increase 1978-1980</u>
West:				
Ogden	1644	3478	5585	240
Fresno	<u>1528</u>	<u>3664</u>	<u>3716</u>	143
Subtotal	<u>3172</u>	<u>7142</u>	<u>9301</u>	193
Southwest:				
Austin	<u>984</u>	<u>1478</u>	<u>1998</u>	103
Northeast:				
Andover	325	693	1767	444
Brookhaven	<u>346</u>	<u>1251</u>	<u>1259</u>	264
Subtotal	<u>671</u>	<u>1944</u>	<u>3026</u>	351
East:				
Philadelphia	<u>667</u>	<u>794</u>	<u>1204</u>	81
Southeast:				
Memphis	325	306	575	77
Atlanta	<u>370</u>	<u>352</u>	<u>510</u>	38
Subtotal	<u>695</u>	<u>658</u>	<u>1085</u>	56
Central:				
Cincinnati	<u>499</u>	<u>543</u>	<u>836</u>	68
Midwest:				
Kansas City	<u>435</u>	<u>387</u>	<u>776</u>	78
Total	<u>7123</u>	<u>12,946</u>	<u>18,226</u>	156

IRS Identified Illegal Tax Protester
Returns By Type Of Scheme
1978-1980

<u>Schemes</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
Constitutional	2534	3885	5930
Family estate trust	836	3888	4117
Church related	486	953	2784
Fair market value	56	219	196
Gold/silver standard	469	317	167
Nonpayment protest (note a)	224	342	643
Protest adjustment (note a)	63	467	533
Blank 1040/1040A	111	189	175
Other	<u>760</u>	<u>900</u>	<u>1,644</u>
Total returns	<u>5539</u>	<u>11,160</u>	<u>16,189</u>
 <u>Nonreturn items</u>			
Form W-4s (note b)	826	680	937
Correspondence	<u>213</u>	<u>148</u>	<u>97</u>
Total non- return items	<u>1039</u>	<u>828</u>	<u>1034</u>
Total	<u>c/6578</u>	<u>c/11,988</u>	<u>c/17,223</u>

a/Nature of protest varied; that is, defense, foreign spending, nuclear plants, etc.

b/Includes only those false forms W-4 IRS classified as being filed by protesters.

c/The annual totals by scheme do not agree with the total returns identified (appendixes II and III) because of adjustments, such as counting only one of the two returns involved in a family estate trust for scheme count purposes.

IRS Questionable Form W-4 Program
1980

	<u>Estimated annual receipts</u>		<u>Actual receipts for First 6 months (April-September 1980)</u>	
	<u>Forms W-4 received</u>	<u>Questionable forms W-4 requiring followup</u>	<u>Forms W-4 received</u>	<u>Questionable forms W-4 requiring followup</u>
Excessive withholding allowances	800,000	20,000	(a)	29,392
Exempt status:	250,000	10,000	(a)	113,978
Prior year tax liability	(a)	(5,000)	(a)	(111,528)
No prior year liability	(a)	(5,000)	(a)	(2,450)
Total	<u>1,050,000</u>	<u>30,000</u>	<u>686,686</u>	<u>143,370</u>

a/Breakdowns were not available.

Projection By Scheme Of The Status Of Protester Cases
Identified By Three IRS Districts In 1978 and 1979

<u>Scheme</u>	<u>Open</u>	<u>Closed</u>	<u>Not pursued</u>	<u>Total</u>
Constitutional	420	151	90	661
Family estate trust	1,345	664	278	2,287
Church-related	178	9	6	193
Gold/silver	54	1	43	98
War protest	19	32	10	61
False form W-4	130	234	0	364
Other	<u>134</u>	<u>48</u>	<u>24</u>	<u>206</u>
Total	<u>2,280</u>	<u>1,139</u>	<u>a/451</u>	<u>3,870</u>
Percent	(59)	(29)	(12)	(100)

a/The major reasons cases were not pursued is because they had either little or no tax potential.

Range Of Days Required For IRS District Office
Functions To Handle Closed Cases (note a)

<u>IRS function</u>	<u>-----Days-----</u>			<u>Largest number of days on a case</u>
	<u>1-179</u>	<u>180-364</u>	<u>365 or more</u>	
Criminal Investigation	115	0	43	700
Examination	56	337	278	790
Post Examination (note b)	334	241	48	482
Appeals	143	143	48	472
Collection	58	10	3	499
District Counsel (Summons Enforcement)	48	0	0	26
District Counsel (Tax Court)	48	48	0	265

a/This table indicates in which phase of the compliance process protester cases are likely to experience delays. The figures do not total because some cases may not have been delayed in every phase.

b/These cases were either awaiting group managers' review or expiration of time allowed taxpayers to respond to IRS notices.

Range Of Accumulated Days Required By IRS
District Office Functions To Handle Open Cases

<u>IRS function</u>	<u>-----Days-----</u>				<u>Total open cases</u>	<u>Largest no. of days on one case</u>
	<u>1-179</u>	<u>180-364</u>	<u>365-729</u>	<u>730-up</u>		
Criminal Investigation	45	0	0	2	47	799
Examination	47	184	405	401	1037	1,739
Appeals	0	0	45	148	193	1,270
Collection	2	1	187	3	193	887
District Counsel	<u>0</u>	<u>0</u>	<u>93</u>	<u>148</u>	<u>241</u>	1,481
Total	<u>94</u>	<u>185</u>	<u>730</u>	<u>702</u>	<u>a/1711</u>	
Percent	(6)	(11)	(43)	(41)		

a/Since these sample cases were still open at the time of our review, the time for each case is cumulative and is not all necessarily attributed to the function where the case was located when we reviewed it. Also, not all open sample cases are included here because some were at the service center rather than at the district office.

Principal Reasons For Delays

<u>Protester caused</u>	Number of cases in three IRS districts (note a)
Withheld records	1,309
Refused to talk to IRS	815
Repeated rescheduling of appointments	270
<u>IRS caused</u>	
Securing related returns	922
Trouble locating return	785
Additional work suggested by reviewer	655
Large caseload	536
Other priority work	438
Leave	231
Training	231
Lost the case file	88
<u>Statutory and other causes</u>	
Appeals process	961
Awaiting taxpayers next action	782
Collection notices process	238
Summons issuance and enforcement	144
Awaiting information from Social Security Administration	86

a/These are projections based on GAO's sample of 167 protester cases identified by three IRS district offices in 1978 and 1979. The figures do not total because some cases had more than one reason for delay.

Sampling Errors For
Projections

<u>Description</u>	<u>GAO</u> <u>estimates</u>	+	Sampling error percentage (<u>note a</u>)
Number of protester cases in the three districts	3,870	+	180 cases
Average dollar amount of proposed additional taxes assessed	\$3,690	+	\$1,902
Total additional taxes involved in protest returns for the three districts in 1978 and 1979	\$10.2 million	+	\$5.3 million
Open cases	2,280	+	377 cases
Closed cases	1,139	+	319 cases
Cases IRS did not pursue	451	+	252 cases
Final tax assessment made	\$2.5 million	+	\$789,676
Cases where final taxes assessed	1,266	+	355 cases

a/Computed at the 95 percent confidence level.